No. 80-1402

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IN THE

Supreme Cou t of the United States

OCTOBER TERM, 1980

FRANK A. PRINCIPE, ANN PRINCIPE, and FRANKIE, INC., a Virginia corporation,

Petitioners,

v.

McDONALD'S CORPORATION, a Delaware corporation, McDONALD'S SYSTEM, INC., an Illinois corporation, and FRANCHISE REALTY INTERSTATE CORPORATION, an Illinois corporation,

Respondents.

On Petition for Writ of Certiorari to the Court of Appeals for the Fourth Circuit

BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

Petitioners have two McDonald's operating rights franchises authorizing them for a 20-year period to operate two specific McDonald's restaurants which McDonald's developed and owns in Hopewell and Colonial Heights, Virginia. When McDonald's denied petitioners' request for a third such franchise for another McDonald's restaurant, petitioners brought this action attacking their existing two McDonald's franchises as illegal tying arrangements.

The questions presented for review are:

1. Whether the courts below, on the basis of an extensive undisputed factual record, correctly held that petitioners failed to prove that a McDonald's operating rights franchise constituted two separate and distinct products and therefore failed to establish the threshold requirement for proving a tie-in.

2. Whether, in light of the undisputed facts and petitioners' failure to offer any controverting evidence, the court below erred in holding that a directed verdict at the close of all the evidence was proper on the particular record in this case.

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BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI

Petitioners Frank Principe, Ann Principe, and Frankie, Inc., a corporation owned by Frank Principe and his son, Ray Principe (collectively referred to herein as "the Principes"), seek review of the Court of Appeals' affirmance of the District Court's directed verdict on the Principes' antitrust "real estate tie-in" claim in favor of respondents, McDonald's Corporation and its former subsidiaries, McDonald's System, Inc., and Franchise Realty

Interstate Corporation (collectively referred to herein as "McDonald's").[1]

None of the relevant considerations governing review on certiorari, as set forth in this Court's Rule 17, supports the grant of the requested writ. The decision of the Court of Appeals is wholly consistent—and is not in conflict—with the decisions of this Court and the other Courts of Appeals. Nor does the decision below merit review by this Court for any other reason. Indeed, all that is involved here is the application of well-established legal principles to the specific record in this case.

STATEMENT OF THE CASE

This action arose out of a controversy between petitioners (who are franchised to operate two McDonald's restaurants in Hopewell and Colonial Heights, Virginia) and McDonald's Corporation with respect to McDonald's decision to offer another franchisee the franchise for a new Petersburg, Virginia McDonald's restaurant. Subsequent to McDonald's decision to offer the Petersburg franchise to another franchisee, petitioners filed a complaint asserting 14 causes of action under the Sherman Act and various other federal and state laws. Each of the 14 claims was either abandoned or rejected below, and the questions tendered by petitioners in this Court relate only to their "real estate tie-in" claim under Section 1 of the Sherman Act

[1] At the time this action was filed, respondents McDonald's System, Inc. and Franchise Realty Interstate Corporation were wholly-owned subsidiaries of McDonald's Corporation. With respect to the then-existing structure, the Court of Appeals found that "the various defendants have substantially similar corporate hierarchies and operate in conjunction under the direction and control of the corporate parent. . . ." (App. 8, 631 F.2d at 305.) Subsequently both McDonald's System, Inc. and Franchise Realty Interstate Corporation were merged into McDonald's Corporation.

(a claim which does not at all involve the Petersburg McDonald's restaurant).[2]

With regard to this claim—despite the fact that they eagerly sought a third such franchise in Petersburg—petitioners assert that a McDonald's operating rights franchise is unlawful on the theory that McDonald's, in providing the franchisee with the right to conduct business as "McDonald's" in one of McDonald's restaurants, allegedly "ties" together (1) a license to use McDonald's trademarks at a specific McDonald's restaurant developed and owned by McDonald's and (2) a lease authorizing occupancy of that restaurant. At the close of all the evidence, the District Court directed a verdict on this claim; and the Court of Appeals affirmed, finding that "on the facts of this case" the lease and license "are not separate products but component parts of the overall franchise package. . . ." and "are integral components of the business method being franchised" and that accordingly no tie-in had been established. (App. 16, 20, 631 F.2d 308, 309.)[3]

A. McDonald's Business and Its Franchising Method

McDonald's is the owner of "McDonald's" fast-service, limited-menu restaurants which McDonald's has located and developed throughout the country. As the court below noted, "All McDonald's restaurants bear the same distinc-

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[2] Although petitioners (p. i) list only two questions relating to their "real estate tie-in" claim, they request in their conclusion (p. 27) that the Court make "*a full review of the record* and the merits of the decision below, *on all issues raised in the appellate court*". (Italics added.) Under this Court's Rules, any questions not set forth in the petition are precluded. (Rule 21.1(a).)

[3] "App." refers to the Appendix (containing the decision of the Court of Appeals) included in the petition for certiorari. "C.A. App." refers to the Joint Appendix submitted to the Court of Appeals below. "Tr." refers to the trial transcript. "PX" and "DX" refer to plaintiffs' and defendants' trial exhibits.

tive features with a few exceptions due to architectural restrictions: the golden arches motif, the brick and glass construction and the distinctive roofline." (App. 11, 631 F.2d at 306.)

In each restaurant it develops (including each restaurant it franchises), McDonald's itself invests a very substantial sum (in 1978 averaging over $450,000 per unit). (App. 11, 631 F.2d at 306.) Approximately one-quarter of McDonald's restaurants are company-operated; the remainder are operated by franchisees. (App. 8-9, 631 F.2d at 305.)

McDonald's does not engage in "rent-a-name" franchising (in which the franchisor merely authorizes the use of its name and concepts in the franchisees' own stores or restaurants). Instead, as the parties stipulated below, a McDonald's franchise—set forth in the license and lease agreements—consists of the rights and authorizations essential to enable the franchisee to operate for an agreed term (usually 20 years) a specific McDonald's restaurant located, developed and owned by McDonald's. (C.A. App. 108.) Since McDonald's owns the restaurant and is entitled to regain possession at the end of the term or in the event of a default, it is able to maintain a location as part of its restaurant system, irrespective of the success or failure of any individual operator (see App. 21-22, 631 F.2d at 310).

Also unlike many "rent-a-name" franchisors, McDonald's does not sell any foodstuffs, supplies or other common articles to its franchisees (see App. 8, 631 F.2d at 305). Instead, apart from the initial payments for the franchise (generally a $12,500 franchise fee and a refundable $15,000 security deposit), McDonald's sole source of franchising income consists of monthly payments received from its franchisees based on the sales (generally 11½%) of its franchised restaurants (see App. 8-9, 12, 631 F.2d at 305, 306).

In order to maximize sales, market penetration and operating efficiencies of the McDonald's System as a whole, the

company through detailed analysis of marketing information systematically plans a pattern of new restaurant placement for different marketing areas. Applying their judgment to this internally developed data, McDonald's personnel decide precisely where and when new restaurants should be located and then proceed to make arrangements for acquisition and development of the desired sites. (See App. 9-10, 631 F.2d at 305-06).

After it is decided to build a McDonald's restaurant on a particular site, a separate independent decision is made as to whether the restaurant should be company-operated or whether it should be franchised. If the decision is to franchise the store, "McDonald's begins the process of locating a franchisee," which "involves offering the store either to an existing franchisee or to an applicant on the franchise waiting list." (App. 10, 631 F.2d at 306.)[4]

As already noted, in each restaurant it franchises, McDonald's itself invests a substantial sum. Consequently it has been possible for McDonald's franchisees (including these petitioners) to become a McDonald's operator with a much smaller investment than the total investment required for restaurant ownership.

McDonald's investment in real estate is solely a function of its ownership of the McDonald's restaurants which it locates and develops. It is not otherwise engaged in the business of offering real estate for sale or lease.

As the courts below found on the undisputed facts, *which petitioners did not controvert by presenting any contrary evidence,* McDonald's approach to franchising serves to increase the System's effectiveness and has resulted in "substantial advantages, both for the company and for fran-

[4] "Applicants . . . need not accept the first franchise they are offered," and indeed "McDonald's often does not know who will operate a franchised store until it is nearly completed because a new restaurant may be offered to and rejected by several different applicants." (App. 10, 631 F.2d at 306.)

chisees." (App. 20, 631 F.2d at 309-10.) Thus, McDonald's method of doing business (a) enables McDonald's "to obtain better sites than franchisees could select" (App. 20, 631 F.2d at 309);[5] (b) "assures that the [franchised] stores remain part of the McDonald's system" regardless of the success or failure of an individual operator, thereby "preserving the goodwill of the system in established markets" (App. 21, 22, 631 F.2d at 310);[6] (c) "reduces a franchisee's initial

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[5] Relying on its experience, and utilizing sophisticated techniques to analyze demand and demographic factors, McDonald's is able to seek the best sites, based solely on the quality of the restaurant location, to plan restaurant development several years in advance, and to carry out a development program even before a specific franchisee-operator has been selected and even before it is determined whether the unit should be franchised or company-operated. Moreover, since McDonald's is engaged in the development of its own restaurant system and offers only individual operating rights, it is able to "approach the problem of site selection from an area wide point of view", by developing long-range marketing plans which are focused on the most effective means of serving a broad community and by also taking account of future demographic developments. (App. 21-22, 631 F.2d at 310; C.A. App. 300-01, 307, 320-21.)

[6] "By owning its own stores, McDonald's assures its continued presence on the [store] site, maintains the store's patronage even during management changes and avoids the negative publicity of having former McDonald's stores used for other purposes." (App. 22, 631 F.2d at 310.) McDonald's ownership of valuable restaurant sites produces "benefits for franchisees" by "preserving the goodwill of the system in established markets." (*Ibid.*)

In this regard, petitioners' own trial testimony included reference to restaurant locations which had initially been publicly identified under a franchisor's name in a "rent-a-name" franchise but were thereafter lost to the franchisor with attendant negative impact on public recognition and goodwill (C.A. App. 175-77). Petitioners also acknowledged that ownership of valuable restaurant sites so that they will not be lost to the franchise system is a legitimate business consideration for the franchisor (C.A. App. 176-77).

investment, thereby broadening the applicant base and opening the door to persons who otherwise could not afford a McDonald's franchise" (*ibid.*);[7] and (d) contributes to the creation of a beneficial community of interest between franchisor and franchisee since "both McDonald's and the franchisee have a substantial financial stake in the success of the restaurant. . . ." (App. 23, 631 F.2d at 310.)[8]

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[7] Inasmuch as McDonald's itself develops McDonald's restaurants, "it can select franchisees based on their management potential rather than their real estate expertise or wealth." (App. 22, 631 F.2d at 310.) McDonald's is thus able to look for people with the qualities that are likely to make them good restaurant operators—not for people with real estate expertise—and the franchisee can devote his energies to restaurant operations.

As the Fourth Circuit noted, the "ability [of franchisees] to begin operating a McDonald's restaurant without having to search for a site, negotiate for the land, borrow hundreds of thousands of dollars and construct a store building is of substantial value to franchisees." (App. 22, 631 F.2d at 310.) Indeed, the record establishes that the Principes could not have obtained financing to construct the Hopewell location (the first McDonald's restaurant which they operated) (App. 22, 631 F.2d at 310 n.8).

[8] Thus ". . . their relationship becomes a sort of partnership that might be impossible under other circumstances." (App. 23, 631 F.2d at 310.) McDonald's approach tends to strengthen the relationship between McDonald's and the operator and lead to operational improvements, since "[n]either can afford to ignore the other's problems, complaints or ideas." (*Ibid.*) Moreover, in light of its "partnership" status with the franchisee, McDonald's has subsequently invested additional funds in order to improve franchise sales or "reduced royalty payments in order to provide franchisees more working capital." (*Ibid.*) In fact, in petitioner's case, McDonald's temporarily reduced payments due from the franchisee so that the restaurant operation could be built up (Tr. 188).

B. The Proceedings Below

1. Background of the Litigation

It was within this framework that petitioners obtained operating rights to McDonald's restaurants in Hopewell and Colonial Heights, Virginia.

Frank A. Principe and his wife Ann first contacted McDonald's in early 1968 about obtaining a McDonald's franchise. Mr. Principe was then in the plumbing and heating business in Kenosha, Wisconsin and the Principes had an estimated net worth of approximately $93,000 (C.A. App. 119).

After Principe was accepted as a registered applicant for a McDonald's restaurant, McDonald's offered—and Mr. Principe rejected—eleven separate restaurants (Tr. 2530). Eventually in 1970 the Principes accepted McDonald's offer to operate a restaurant located in Hopewell, Virginia. After being informed by McDonald's that it was constructing the restaurant in Hopewell, and being asked whether they wanted the location, the Principes agreed to accept McDonald's offer. That agreement was subsequently detailed in two interrelated documents prepared, presented, and executed simultaneously: a lease authorizing occupancy of the Hopewell McDonald's restaurant and a license authorizing its operation as part of the McDonald's System.[9] (DX 4, 4A.)

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[9] It was undisputed that use of those two documents (and the division of the monthly percent of sales payment between them) resulted entirely by reason of the initial arrangement between Ray Kroc (McDonald's founder) and the McDonald brothers. Because of that arrangement, use of a second document was necessary in order to introduce new contract terms and payment provisions. (C.A. App. 111-12; see App. 11-12, 631 F.2d at 306 n.5.) Although petitioners declined to so stipulate, they adduced no evidence to the contrary.

Subsequently, in August, 1974, McDonald's offered Frank and Ray Principe a franchise to operate a McDonald's restaurant in Colonial Heights, Virginia, and the offer was accepted (PX 14). Once again the initial agreement was subsequently detailed in lease and license documents authorizing occupancy and operation of the specified McDonald's restaurant.

With respect to each of the two franchised restaurants, plaintiffs paid McDonald's an initial consideration of $27,500—$15,000 of which is a refundable deposit to be repaid at the end of the term (unless offset by liabilities)[10] —and a monthly payment based on a percentage of sales. Since 1975, the Principes have drawn no less than $125,000 annually from the two restaurants (DX 11-20) and their net worth now exceeds one million dollars (Tr. 1077).

In 1976, McDonald's succeeded in acquiring an appropriate site in Petersburg, Virginia for developing a McDonald's restaurant. The Principes requested a franchise for the Petersburg restaurant. However, McDonald's regional manager concluded that the restaurant should be franchised to a new franchisee, on the ground that the Principes had not yet shown the management depth and capability to effectively manage three McDonald's units

[10] One of petitioners' claims dismissed before trial was that McDonald's "tied" those security deposits (evidenced by a document titled "note") to the license. (App. 6, 631 F.2d at 304). The Court of Appeals found that the security deposit claim did not warrant "extended discussion" and held that the "security deposit note was just that: evidence of a security deposit on a lease which we have held was a legitimate part of the franchise package." (App. 24, 631 F.2d at 311.) Petitioners (p. i) do not present this question for review.

(the new unit plus their existing two franchises) without impairing the quality of the restaurants. (C.A. App. 151.) In May, 1978, following an extended test period during which the Principes' management was further scrutinized, the regional manager advised the Principes that a final decision had been reached to grant the Petersburg franchise to a new franchisee (PX 49). They filed their complaint in this case (C.A. App. 27-39) a few days later.

2. District Court Proceedings

After considering all the trial evidence, the District Court directed a verdict for McDonald's on the "real estate tie-in" claim.[11] The Court held on the facts presented that a McDonald's franchise—authorizing the franchisee to operate a specific McDonald's restaurant—does not involve a "tie-in" of two separate and distinct products. The District Court pointed out that the bundle of benefits obtained by a McDonald's franchise "in return for the 11½ percent of gross sales" is of "a tremendous size and is capable of being broken down into almost innumerable components" (C.A. App. 6), including "even the roof line . . . of a building that is so distinctive that the benefit to the franchisee is substantial, and it's part of the bundle" (C.A. App. 9). The Court held that petitioners had not shown it to be a "tie-in" when McDonald's ". . . bundles together an *in situ* hamburger business and says 'Are there any takers?', and it's clear that there are." (C.A. App. 10.)[12]

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[11] On the other hand, the District Court submitted to the jury petitioners' claim that McDonald's denial of the Petersburg franchise had been based on price-fixing grounds. The jury rejected that claim, and petitioners (p. i) do not present that claim for review.

[12] The District Court also ruled that plaintiffs had not met their burden of showing that McDonald's had the requisite economic power in the market for the alleged tying product (C.A. App. 11-12). The Court of Appeals in its decision did not reach that issue.

3. The Court of Appeals Decision

The Court of Appeals affirmed the District Court's decision that petitioners had failed to prove the threshold requirement for a tie-in—i.e., two separate and distinct products. Accordingly "we hold on the facts of this case there was no illegal tie-in" (App. 16, 631 F.2d at 308).

On the basis of its detailed review of the undisputed facts, the Court found that the lease and license "are not separate products but component parts of the overall franchise package" and "are integral components of the business method being franchised"; that "the challenged aggregation is an essential ingredient" of McDonald's "formula for success"; and that the "lease is not separable from the McDonald's franchise to which it pertains". The Court also found that McDonald's franchising method "has substantial advantages, both for the company and for franchisees" and "is part of what makes a McDonald's franchise uniquely attractive to franchisees." (App. 16, 20, 631 F.2d at 308-10.)

A petition for rehearing and suggestion for rehearing *en banc* was denied (App. 25).

ARGUMENT

I. Petitioners' Asserted Reasons For Granting Certiorari Rest On An Egregious Distortion Of The Decision Below.

Although hyperbole is not unusual among litigants seeking review by this Court, petitioners in this case carry hyperbole well beyond any conceivably excusable bounds. In disregard of the Fourth Circuit's limited holding and its well-reasoned opinion, petitioners would have this Court believe that the Fourth Circuit defied the decisions of this Court and all other Courts of Appeals, and adopted a radical new standard which threatens antitrust enforcement.[13] Nothing could be further from the truth, as examination of the opinion below will readily confirm. There is no conflict and no other reason for review by this Court.

Applying established legal principles to the undisputed facts and the particular record developed at trial, the Fourth Circuit merely (and correctly) held that a lease and a license which together convey the rights needed to operate a specific company-owned restaurant are "not separate products but component parts of the overall franchise package" and "integral components of the business method being franchised" so that "*on the facts of this case* there was no illegal tie in." (App. 16, 631 F.2d at 308, italics added.) Thus, petitioners failed to meet the first requirement of establishing a tie-in—i.e., proving that the alleged tying and tied products constitute two separate and distinct products.

That being so, the Court did not reach or discuss or decide the variety of irrelevant issues which petitioners seek

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[13] For example, according to petitioners (p. 22), the decision below "eliminates—at least in the Fourth Circuit—the body of case law which holds tying unlawful" and "The franchisor is now given free rein to fashion his marketing plan around any aggregation of products which may be commercially attractive and viable. . . ." See also Petition, p. 27: "The decision . . . announces a new rule which in effect grants unfettered license to any franchisor. . . ."

to inject into the case. Thus, in view of plaintiffs' failure to prove the requisite two separate products, there was no occasion or reason to consider other tie-in requirements such as "economic power"[14] or "coercion".[15]

Likewise, since no tie-in was established, there was no occasion or reason to consider what "justification", if any, can excuse a tie-in.[16] In this connection, petitioners are egregiously in error in ascribing to the Fourth Circuit "a

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[14] Petitioners (pp. 9-10) accordingly mis-cite cases such as *United States Steel Corp.* v. *Fortner Enterprises, Inc.*, 429 U.S. 610 (1977); *Northern Pacific Ry. Co.* v. *United States*, 356 U.S. 1 (1958); *Hill* v. *A-T-O, Inc.*, 535 F.2d 1349, 1354 (2d Cir. 1976) ("an admitted tie between two clearly separate products"); and *Ware* v. *Trailer Mart, Inc.*, 623 F.2d 1150 (6th Cir. 1980). The three Fourth Circuit tie-in cases cited at pp. 17-20 of the petition—*Osborn, Advance Business Systems* and *Phillips* (see note 17, *infra*)—also involved the "economic power" issue, which presupposes the existence of a separate and distinct tying product.

[15] Cases cited by petitioners (pp. 9, 11, 12, 19) which dealt with the "coercion"—but not the one-product—issue include *Bogosian* v. *Gulf Oil Corp.*, 561 F.2d 434 (3d Cir. 1977), cert. denied, 434 U.S. 1086 (1978); *Heatransfer Corp.* v. *Volkswagenwerk, A.G.*, 553 F.2d 964 (5th Cir. 1977), cert. denied, 434 U.S. 1087 (1978); *Advance Business Systems and Supply Co.* v. *SCM Corp.*, 415 F.2d 55 (4th Cir. 1969), cert. denied, 397 U.S. 920 (1970). The "coercion" question becomes relevant only after it has been decided that two products do indeed exist.

[16] Wholly inapposite here are cases cited by petitioners (p. 9) such as *International Salt Co.* v. *United States*, 332 U.S. 392 (1947), and *International Business Machines Corp.* v. *United States*, 298 U.S. 131 (1936). In those decisions, this Court, dealing with tie-in arrangements indisputably involving the requisite two separate products, refused to recognize certain defenses, justifications or explanations for those tie-in arrangements.

Also inapposite is the discussion of tie-in justification in *United States* v. *Jerrold Electronics Corp.*, 187 F.Supp. 545, 555-61 (E.D. Pa. 1960), aff'd per curiam, 365 U.S. 567 (1961) (Petition, pp. 12-13). By contrast, in this case, McDonald's has not sought to justify

determination that an otherwise illegal tie can be justified with the introduction of market research data" and a holding that "a success motive will excuse judicial condemnation" (Petition, pp. 13-14, 24). The Fourth Circuit held nothing of the kind. The question decided below was whether a tie-in exists—not whether a tie-in found to exist can be justified or excused. The latter question might only have become germane if petitioners had met their burden of proving a tie-in of two separate and distinct products.

Similarly, the Court of Appeals did not depart in the slightest from its earlier decisions (Petition, pp. 17-20)[17] or the decisions of other courts (see Petition, p. 9 n.4) with regard to the application of the *per se* rule to tie-ins. Patently, even though an agreement would be illegal *per se* if all the requirements of a tie-in were satisfied, the existence of a *per se* rule does not relieve a plaintiff from meeting the requirements of a tie-in.

In short, petitioners' assertion of a "conflict of Olympian proportions" (Petition, p. 8) and "[r]adical departure"

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a two-product tie-in; instead, it has been McDonald's contention—and the Court of Appeals found—that only one product exists, so that the tie-in label is, at the outset, inapplicable.

[17] Neither *Osborn* v. *Sinclair Refining Co.*, 286 F.2d 832 (4th Cir. 1960), cert. denied, 366 U.S. 963 (1961) (Petition, pp. 17-19), nor *Advance Business Systems and Supply Co.* v. *SCM Corp.*, 415 F.2d 55 (4th Cir. 1969), cert. denied, 397 U.S. 920 (1970) (Petition, pp. 19-20), involved the question of whether two separate and distinct products existed. Finally, *Phillips* v. *Crown Central Petroleum Corp.*, 602 F.2d 616 (4th Cir. 1979), cert. denied, 444 U.S. 1074 (1980) (Petition, p. 20), while not specifically addressing the one-product issue, was cited by the Fourth Circuit in *Principe* for the proposition that "the very essence of a franchise is the purchase of several related products in a single competitively attractive package." *Id.* at 628, cited by the Fourth Circuit at App. 19, 631 F.2d at 309. *Phillips* thus supports, rather than contradicts, the decision below.

(Petition, p. 23) rests on a scandalously spurious definition of the legal issues presented here. Petitioners attack a non-existent opinion, setting up and then knocking down a line of strawmen with immaterial cases.

II. The Decision Below, Applying Well-Established Principles To The Particular Facts Of This Case, Does Not Conflict With Any Other Decisions.

As the First Circuit held in *Dehydrating Process Co.* v. *A. O. Smith Corp.*, 292 F.2d 653, 655 (1st Cir.), cert. denied, 368 U.S. 931 (1961)—one of the cases which petitioners (p. 9 n.4) erroneously assert is in conflict with the decision below—while it may be true "that the compulsory joining of two 'separate' articles is a per se violation" of the Sherman Act, "[t]his statement . . . solves nothing", for "Whatever may be meant by per se, we must first consider what may be fairly treated by a seller as inseparable".

It is possible, of course, to dissect any business transaction into two or more component parts, particularly in a franchising context. The possibility of such dissection, however, does not establish the existence of two products—and even more clearly does not establish the existence of two separate and distinct products. See, e.g., *Siegel* v. *Chicken Delight, Inc.*, 448 F.2d 43 (9th Cir. 1971), cert. denied, 405 U.S. 955 (1972)—another case upon which petitioners (p. 10) strongly rely—in which the Ninth Circuit pointed out that tie-in rules are not "designed to strike . . . at the mere coupling of physically separable objects" (p. 47), distinguished a situation (as here) involving a "preassembled package" (p. 48 n.4), and emphasized the need to examine "the function of the aggregation" (p. 48). See also *Dehydrating Process, supra* ("Articles, though physically distinct, may be related through circumstances", including "the sound business interests of the seller").

Thus, in *Kugler* v. *AAMCO Automatic Transmissions, Inc.*, 460 F.2d 1214 (8th Cir. 1972), in holding "as a matter of law" that the AAMCO trademark license and advertising materials did not constitute separate and distinct products, the Eighth Circuit held:

> "The franchise in this case consists of more than the mere right to use the trade name AAMCO. For a stated consideration, AAMCO agreed to provide, *in a single package,* a means and method of operating and merchandising a transmission repair shop. National, as well as local, advertising services became *an integral and inseparable aspect of that package agreement*". (Pp. 1215-16, italics added.)

Similarly, in *In re 7-Eleven Franchise Antitrust Litigation,* 1974-2 Trade Cases ¶ 75,429 (N.D. Cal.), in holding as a matter of law that the 7-Eleven franchise and trademarks could not be severed from the alleged tied products—including real estate—the court concluded:

> "Defendant here is not in the business of selling insurance, advertising, accounting service, real estate or any of the allegedly tied items. Nor are they in the business of selling bare franchises. *The only thing they have for sale is an overall package,* which includes the franchise and a group of services which constitute *an integral part of the total package.*" (P. 98,427, italics added.)

The same principles have been applied in numerous other cases as well.[18]

The Ninth Circuit *Chicken Delight* decision, *supra*—far from being in conflict with the decision below—is entirely

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[18] See, e.g., *Redd* v. *Shell Oil Co.*, 524 F.2d 1054 (10th Cir. 1975), cert. denied, 425 U.S. 912 (1976) (combination of trademark and required gasoline purchases constituted single product); *Barnosky Oils, Inc.* v. *Union Oil Co. of California,* 1979-1 Trade Cases ¶ 62,668 (E.D. Mich.) at pp. 77,786-789 (same); *Krehl* v. *Baskin-Robbins Ice Cream Co.,* 1979-2 Trade Cases ¶ 62,806 (C.D. Cal.) at pp. 78,706-707 (combination of trademark and required ice cream purchase constituted single product); *Foster* v. *Maryland*

in accord. The one-product issue, the Ninth Circuit held, turns on "the function of the aggregation" (448 F.2d at 48). Applying that test to a "rent-a-name" franchise requiring the franchisee to purchase his future requirements of standard supplies and equipment from the franchisor, the Court held:

> ". . . it is apparent that the goodwill of the Chicken Delight trademark does not attach to the multitude of separate articles used in the operation of the licensed system or in the production of its end product." (P. 49.)

On that basis, the Court rejected "attempts by tie-in to extend the trademark protection to *common articles (which the public does not and has no reason to connect with the trademark)* . . ." (*ibid.*, italics added).[19]

State Savings and Loan Ass'n, 590 F.2d 928, 931 (D.C. Cir. 1978), cert. denied, 439 U.S. 1071 (1979) ("plaintiffs' payment of attorney's fee charge to the defendant lender represented an incidental and inseparable part of their 'purchase' of the loans, rather than the 'purchase' of a tied product"); *Washington Gas Light Co.* v. *Virginia Electric Power Co.*, 438 F.2d 248, 253 (4th Cir. 1971) (electricity and its delivery held to be a single product; delivery "has always been an ancillary and necessary part of the business of producing and selling electrical power."); *Foster* v. *West Alexandria Properties, Inc.*, 1980-1 Trade Cases ¶ 63,223 (E.D. Va.) (contracting of the services of a management firm was an ancillary and neccessary part of the business of selling condominiums.)

[19] The limited scope of the *Chicken Delight* ruling has been repeatedly emphasized by district courts in the Ninth Circuit. See, e.g., *7-Eleven, supra; Krehl, supra; Cash* v. *Arctic Circle, Inc.*, 85 F.R.D. 618 (E.D. Wash. 1979); *Hirsch* v. *Martindale-Hubbell, Inc.*, 1980-81 Trade Cases ¶ 63,786 (D. Ariz. 1981); *JBL Enterprises, Inc.* v. *Jhirmack Enterprises, Inc.*, 1981-1 Trade Cases ¶ 63,870 (N.D. Cal.) at p. 75,516. Thus, in *Krehl*, as in this case, the court directed a verdict in favor of defendants on the one-product issue and noted that "*Siegel* v. *Chicken Delight* stands for the proposition that a trademark or trade name may be a separate product, but not that as a matter of law, it must be." 1979-2 Trade Cases at p. 78,706.

In this case, by contrast, the parties stipulated that "McDonald's sells rights and authorizations which enable an individual to engage in a restaurant operations business, operating a specific McDonald's restaurant which has been located, constructed and is owned by McDonald's or one of its subsidiaries" (C.A. App. 108). Indeed, as petitioner Ray Principe acknowledged in his trial testimony, the consuming public looks for these *McDonald's restaurants* and identifies a *McDonald's restaurant* with McDonald's trademarks (C.A. App. 178). In addition, there is no attempt as in *Chicken Delight* to exploit the trademarks as leverage to compel the purchase of "common articles" not represented by the marks. Under such circumstances, the McDonald's trademarks or license cannot be properly severed and treated as separate and distinct from the restaurant which the trademarks identify and which the license authorizes the franchisee to operate.

Thus, the McDonald's franchise concededly consists of far more than the mere right to use McDonald's trademarks. Instead, "For a stated consideration, [McDonald's] agreed to provide, in a single package, a means and method of operating" a specific McDonald's restaurant. *Kugler* v. *AAMCO Automatic Transmissions, Inc.*, 460 F.2d 1214, 1215 (8th Cir. 1972). On the undisputed facts of this case, the lease and license are integral parts of a single product—in the District Court's words, "an *in situ* hamburger business".

In determining that the alleged tied items are "integral components of the business method being franchised" and "component parts of the overall franchise package", the Fourth Circuit analyzed the "substantial advantages, for both the company *and for franchisees*" (italics added) which result from McDonald's franchising method. Contrary to petitioners' distorted reading of the opinion (Petition, p. 22), however, the Court did not hold that "success" justified an illegal tie-in. Rather, the benefits of McDonald's franchising method serve to demonstrate the legitimacy of

the "function of the aggregation" and the inseparability of its essential components.[20]

The cases relied on by petitioners are either patently mis-cited (e.g., *Dehydrating Process*) or simply represent the application of the same principles to different factual situations—typically involving attempts, as in *Chicken Delight,* to improperly extend trademarks to "common articles". In neither event is there a conflict.

In *Carpa, Inc.* v. *Ward Foods, Inc.*, 536 F.2d 39 (5th Cir. 1976), the franchise agreement compelled the franchisee to purchase its requirements of "common articles"—i.e., "all foods, supplies, and equipment"—from the franchisor (pp. 43, 44, 50). Although a claim for "rental overcharges" was made in the case, the background and nature of that claim are not described in the opinion, the lease is not identified in the opinion as an alleged tied product, and the opinion does not deal with the lease as an issue under any tie-in analysis. Indeed, the Fifth Circuit opinion characterized the lease as being "collateral to the tying arrangement" (536 F.2d at 54).

In *Northern* v. *McGraw-Edison Co.*, 542 F.2d 1336 (8th Cir. 1976), cert. denied sub nom. *McGraw-Edison Co.* v. *Soper,* 429 U.S. 1097 (1977), the issue was likewise confined to the required purchase of common items of equip-

[20] Nor, as petitioners (pp. 22, 27) suggest, are the advantages to McDonald's and its franchisees from McDonald's "formula" only supported by bald assertions. At trial McDonald's adduced testimony demonstrating how McDonald's approach to franchising increased the System's effectiveness to the benefit of both McDonald's and its franchisees. That testimony was uncontradicted. Indeed, it was corroborated in large measure by petitioners' own testimony. Petitioners offered no evidence showing that the "function of the aggregation" was to stifle competition or that the "substantial advantages" to which the Fourth Circuit refers do not really exist.

ment and involved, moreover, a sham device used by the manufacturer of the equipment to merchandise its equipment.[21] As the Fourth Circuit noted, "Both *Northern* and *Carpa, Inc.* were concerned primarily with equipment and supplies tie-ins; store leases were only the vehicles by which the illegally tied packages were conveyed." (App. 18, 631 F.2d at 309 n.6.)

Petitioners' reliance on *Photovest Corp.* v. *Fotomat Corp.*, 606 F.2d 704 (7th Cir. 1979), *cert. denied*, 445 U.S. 917 (1980), is also misplaced. That opinion (construing the Indiana antitrust law) does not even address the one-product issue and, as the Fourth Circuit noted, gives no reasons for assuming separability. (App. 19, 631 F.2d at 309 n.6.) Nor, as the Fourth Circuit also noted, was there any "argument that Fotomat had greater expertise than its franchisees, conducted elaborate market research, or invested substantial sums of money." (App. 19, 631 F.2d at 309 n.6.)[22]

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[21] The equipment manufacturer, already engaged in a separate dry cleaning equipment business, developed a separate franchising business for the purpose of selling equipment, and attempted to circumvent the prohibition on tied equipment sales by a sham arrangement whereby an agent would purchase the equipment and then, acting as a "conduit" pursuant to the scheme, resell the equipment as a package to the franchisee (pp. 1344-46). The Court correctly held that "A distribution method which is illegal when conducted by a manufacturer is not rendered legal by the simple expedient of enlisting agents to perform the same activity on behalf of and under the control of the manufacturer" (p. 1345).

[22] *Photovest* involved a master "rent-a-name" franchise for a designated area. As a condition of obtaining the master franchise entitling it to obtain future individual franchises in the area, the area franchisee was obliged to agree that for each such future location it would rent from the franchisor a movable "kiosk" (which the franchisor manufactured) and the site on which it was placed (typically in a shopping center parking lot). As the Seventh Circuit pointed out, "there was no operational reason" for structuring the arrangement in that manner (pp. 724-25). The case thus was not significantly different from *Chicken Delight*—the area fran-

As the Fourth Circuit correctly noted, neither *Carpa* nor *Northern* nor *Photovest* "dealt in any detail with the issue before this court: whether a franchise package granting the right to conduct a business in a specific company owned store can be separated into tying and tied products." (App. 18, 631 F.2d at 309 n.6.) Furthermore, each of those decisions, even if deemed correct on its facts, is inapplicable here. Not only does the McDonald's franchise consist of a "preassembled package", comprised of "integral components of the business method being franchised", but there is no use of the leverage of a trademark license to compel franchisees to purchase "common articles" from the franchisor. Indeed, unlike each of the franchisors in the cases relied upon by plaintiffs, McDonald's does not sell any equipment, foodstuffs or other supplies to its franchisees.

Finally, it should be reemphasized that the Fourth Circuit did not hold that a trademark license could *never* be a tying product or that real estate could *never* be a tied product. What it held was that, in *this* case and on *this* record, there was no basis for any claim that McDonald's operating rights franchise constituted two separate products.

III. The Courts Below Correctly Applied The Universally Accepted Standard For Directed Verdicts.

As this Court has pointed out, the purpose of a directed verdict is to avoid the "mischance of speculation over legally unfounded claims" by the jury. *Brody* v. *Southern Ry. Co.*, 320 U.S. 476, 480 (1943). Accordingly, the standard for a directed verdict is whether the disputed evidence is legally sufficient to submit the case to the jury and whether the plaintiff has adequately established the elements of a required *prima facie* case. E.g., *Foster* v. *Maryland State*

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chisee was obliged by the master franchise agreement to obtain his future requirements from the franchisor and the only "function of the aggregation" was to provide income to the franchisor.

Savings and Loan Ass'n, 590 F.2d 928, 930 (D.C. Cir. 1978), cert. denied, 439 U.S. 1071 (1979) (similarly upholding directed verdict for defendant on one-product question); 6A Moore's Federal Practice ¶ 59.04[5] at 59-19 to 20. Characterizing an issue as "factual" (e.g., Petition, pp. 13, 17) certainly does not preclude a directed verdict where the plaintiff—as in this case—totally fails to meet his evidentiary burden on such an issue.

Here, on the particular record developed at trial and without weighing the credibility of the witnesses, there could be but one reasonable conclusion—that petitioners had failed to prove a "tie-in" of two separate and distinct products. Although petitioners' counsel persisted in *arguing* that each element of a tying violation had been satisfied (Petition, p. 24), petitioners did not contest—and indeed stipulated to—the nature of McDonald's business and its operating rights franchise. Nor did they adduce any evidence either contradicting McDonald's extensive evidence concerning "the function of the aggregation" or showing that McDonald's method of doing business bears any relationship, in anti-competitive effects or otherwise, to the two-product tie-ins condemned by this Court. The factual issues germane to the one-product question were thus not controverted by contrary evidence, and accordingly in those circumstances a directed verdict was wholly appropriate.

In numerous similar situations, courts have directed jury verdicts or granted summary judgment for franchisors on

the one-product question.[23] There is no conflict and plainly no basis for petitioners' request "for a full review of the record" (Petition, p. 27).

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[23] E.g., *Ron Tonkin Gran Turismo, Inc.* v. *Fiat Distributors, Inc.*, 1980-81 Trade Cases ¶ 63,854 (9th Cir. 1981) at p. 78,534; *Kugler* v. *AAMCO Automatic Transmissions, Inc., supra; In re 7-Eleven Antitrust Litigation, supra; Barnosky Oils, Inc.* v. *Union Oil Co. of California, supra; Response of Carolina, Inc.* v. *Leasco Response, Inc.*, 537 F.2d 1307 (5th Cir. 1976) (district court directed verdict on one-product, coercion and economic power issues); *Kypta* v. *McDonald's Corp.*, 1979-2 Trade Cases ¶ 62,827 (S.D. Fla.). See also *Redd* v. *Shell Oil Co., supra; Foster* v. *Maryland State Savings and Loan Ass'n, supra; ILC Peripherals Leasing Corp.* v. *International Business Machines Corp.*, 448 F.Supp. 228 (N.D. Cal. 1978); *Foster* v. *West Alexandria Properties, Inc.*, 1980-1 Trade Cases ¶ 63,223 (E.D. Va.). Accord, e.g., *Bob Maxfield, Inc.* v. *American Motors Corp.*, 1980-81 Trade Cases ¶ 63,824 (5th Cir. 1981) (affirming directed verdict on tie-in claim; lack of evidence of coercion); *Contractor Utility Sales Co.* v. *Certain-Teed Products Corp.*, 1980-81 Trade Cases ¶ 63,714 (7th Cir. 1981) (affirming directed verdict on antitrust conspiracy claim); *Edward J. Sweeney & Sons, Inc.* v. *Texaco, Inc.*, 1980-81 Trade Cases ¶ 63,611 (3d Cir. 1980) (affirming directed verdict on antitrust conspiracy claim); *California Computer Products, Inc.* v. *International Business Machines Corp.*, 613 F.2d 727 (9th Cir. 1979) (affirming directed verdict on monopolization claim).

CONCLUSION

The decision of the Court of Appeals bears no resemblance to its characterization by petitioners. Far from representing an assault on the Sherman Act, the Fourth Circuit's holding that petitioners had failed to meet the threshold requirement for proving a tie-in is fully consistent with well-established legal principles. Nor is review warranted for any other reason. Accordingly the petition for certiorari should be denied.

Respectfully submitted,

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